(2)

No. 97-147

In the Supreme Court of the United States

OCTOBER TERM, 1996

ATLANTIC MUTUAL INSURANCE CO. AND INCLUDIBLE SUBSIDIARIES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

SETH P. WAXMAN
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
DAVID I. PINCUS
EDWARD T. PERELMUTER
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

35 pp

QUESTION PRESENTED

Whether 26 C.F.R. 1.846-3(c) correctly interprets the term "reserve strengthening" as used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases:

In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 97-147

ATLANTIC MUTUAL INSURANCE CO. AND INCLUDIBLE SUBSIDIARIES, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. A1-A25) is reported at 111 F.3d 1056. The opinion of the Tax Court (Pet. App. A26-A47) is unofficially reported at 71 T.C.M. (CCH) 2154.

JURISDICTION

The judgment of the court of appeals was entered on April 24, 1997. The petition for a writ of certiorari was filed on July 21, 1997. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Petitioner is a property and casualty insurance company (Pet. App. A6). Such companies maintain an accounting reserve for their "unpaid losses." The reserve for unpaid losses consists of amounts that each insurer estimates it will ultimately be required to pay (i) on losses already reported ("case reserves"), (ii) on losses not yet reported but estimated to have occurred ("incurred but not reported" loss reserves) and (iii) in connection with the determination and adjustment of such losses ("loss adjustment expense" reserves) (*id.* at A6 n.4).

During the 1986 taxable year, petitioner made net additions to the reserves it maintained for accidents that occurred prior to that year. Those increases in reserves were not attributable to any changes in the methods of estimation (Pet. App. A45). Instead, they were the result of additional experience on the loss claims and "routine adjustments" by claims adjusters (*ibid.*).

Section 1.846-3(c)(3) of the Treasury Regulations defines the term "reserve strengthening," as used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986, generally to include any additions made to net reserves, even if stemming from routine adjustments. The Commissioner of Internal Revenue therefore determined that the increases to petitioner's reserves for losses occuring prior to 1986 constituted "reserve strengthening" under Section 1023(e)(3)(B) of the Tax Reform Act of 1986 (Pet. App. A7). Based on that determination, petitioner was required to recognize additional taxable income of $1,339,039 for 1987, with a resulting deficiency in tax of $519,987 for that year (*ibid.*).

2. Petitioner commenced this action in Tax Court to contest the deficiency determination of the Commissioner (Pet. App. A7).

a. The issue addressed in this case is whether Section 1.846-3(c) of the Treasury Regulations (26 C.F.R. 1.846-3(c)) correctly defines the term "reserve strengthening," as used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986, to include changes in reserves attributable to routine claims adjustment. That question was first considered by the Tax Court in *Western National Mutual Insurance Co.* v. *Commissioner*, 102 T.C. 338 (1994), aff'd, 65 F.3d 90 (8th Cir. 1995). In that case, the taxpayer argued that the term "reserve strengthening" is understood in the insurance industry to involve only those increases to reserves that result from changes in the assumptions or methodology used to compute reserves. The taxpayer contended in that case, as here, that the term does not encompass the type of increases to unpaid loss reserves that result from routine claims processing. 102 T.C. at 346-347. The taxpayer in *Western National* introduced expert testimony that purported to establish the technical meaning of the term "reserve strengthening" in the insurance industry. The Commissioner did not offer any opposing expert testimony in that case. Instead, the Commissioner relied on the legislative history of Section 1023(e)(3)(B) to support the definition of the term "reserve strengthening" contained in the agency's interpretive regulation. 102 T.C. at 347.

In *Western National*, the Tax Court invalidated the regulation in a reviewed opinion with four judges dissenting. The majority relied on the taxpayer's expert witnesses in concluding that the term "reserve strengthening" has an "industry meaning"

that is narrower than the definition contained in the agency's regulation. 102 T.C. at 360. The court concluded that the statute incorporates the "industry usage" of the term and is therefore "neither unambiguous nor imprecise" (*id.* at 360 & n.25). Because the interpretive regulation conflicts with the "industry meaning" of the term "reserve strengthening," the court concluded that the regulation conflicts with the statute and is therefore invalid. On appeal, the Eighth Circuit affirmed. 65 F.3d 90 (1995).

b. In the present case, both the Commissioner and the taxpayer introduced expert reports at trial that addressed the meaning of "reserve strengthening" in the property and casualty insurance industry. Those expert reports, which are summarized in detail by the court below, "ma[de] clear that the term 'reserve strengthening' as used in section 1023(e)(3)(B) is subject to more than one interpretation" (Pet. App. A9 & n.5). See also *id.* at A43.

The Tax Court nonetheless again concluded that the taxpayer was not liable for the asserted deficiency (Pet. App. A27). The court stated that its prior decision "was not based solely on expert testimony" (*id.* at A46) but also on the legislative history of the provision (*id.* at A36-A38). The court acknowledged that the Conference Committee "substantially revised the 'reserve strengthening' language contained in both the Senate bill and in the accompanying Senate Finance Committee Report," which had limited reserve strengthening to changes in reserve practices (*id.* at A36). The court further noted that the Conference Committee Report "provided a more expansive definition of the term [reserve strengthening] than that contained in the Finance Committee

report" (*id.* at A38). The court therefore agreed that the agency's regulation "provided a definition of 'reserve strengthening' consistent with the conference committee report" (*id.* at A41). But, in *Western National*, the court had emphasized that the Conference Committee Report *also* states that the limitation on "reserve strengthening" is designed "to prevent taxpayers from artificially increasing" reserves (*id.* at A42, quoting H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. at II-367 (1986)). The court reasoned that this reference to artificial adjustments refers "to changes in assumptions or methodology" rather than routine loss adjustments (Pet. App. A42). The court ultimately concluded that, despite the Commissioner's "cogent arguments to the contrary," principles of *stare decisis* required it to adhere to the decision in *Western National* (*id.* at A45).

3. The court of appeals reversed (Pet. App. A1-A25). The court concluded that there is no plain meaning, or consistent industry usage, of the term "reserve strengthening" as that term is used in Section 1023(e)(3)(B) of the Tax Reform Act of 1986. To the contrary, the "expert testimony here makes clear that the term 'reserve strengthening' as used in [the statute] is subject to more than one interpretation" (Pet. App. A9 & n.5). In view of the "lack of an explicit statutory definition of reserve strengthening" and "the conflicting definitions of reserve strengthening provided by the expert witnesses," the court held that "the Tax Court erred as a matter of law in holding that the meaning of reserve strengthening in section 1023(e)(3)(B) was plain" (Pet. App. A15).[1]

---

[1] The court of appeals also stated that the Tax Court erred in *Western National* by relying on the meaning of the term

Finding the words of the statute to be ambiguous, the court concluded that it is required by *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), "to take a deferential approach to ascertaining whether the agency's interpretation is a permissible one" (Pet. App. A15). The court emphasized that "where reasonable minds may differ * * * , courts should defer to the informed experience and judgment of the agency to whom Congress delegated appropriate authority" (*id.* at A24 n.13, quoting *Mourning* v. *Family Publications Services, Inc.*, 411 U.S. 356, 371 (1973)). The court held that the broad definition of "reserve strengthening" contained in the regulation satisfies this deferential standard because the agency's interpretation is consistent with the language of the statute, its history and its underlying purpose (Pet. App. A15-A25).

"reserve strengthening" as used in the *life* insurance industry. The court explained that the meaning of "reserve strengthening" in the life insurance industry has no direct relevance to the meaning of that term in the property and casualty insurance industry (Pet. App. 12a-13a):

> [L]ife insurance companies and P & C insurers are taxed in entirely separate manners. Gross income as well as loss reserves are computed on different bases and assumptions. Actuarial assumptions about interest rates and mortality rates are an integral part of computing future losses which form the basis of the loss reserves in life insurance. On the other hand, P & C loss reserves are determined primarily based on past claims experience and the judgments of the individual claims adjusters.

DISCUSSION

The court of appeals correctly held that the regulation establishes a permissible interpretation of Section 1023(e)(3)(B) of the Tax Reform Act of 1986. The decision in this case, however, conflicts with the decision of the Eighth Circuit in *Western National Mutual Insurance Co.* v. *Commissioner*, 65 F.3d 90 (8th Cir. 1995). The issue addressed in these conflicting decisions affects the 1987 tax liability of a significant portion of the property and casualty insurance industry, with consequences for taxable income in excess of $1 billion. Although it is possible that this conflict could be reconciled in future litigation, we do not oppose the granting of certiorari in this case.

1. Section 832(c)(4) of the Internal Revenue Code authorizes a deduction for "losses incurred" in computing the taxable income of a property and casualty insurance company. 26 U.S.C. 832(c)(4). Prior to 1986, the term "losses incurred" was defined by Section 832(b)(5) of the Code to mean the amount of "losses paid" during the year plus the increase (or minus the decrease) in "unpaid losses." 26 U.S.C. 832(b)(5) (1982).[2] That pre-1986 provision gave an unwarranted benefit to property and casualty companies, for it failed to take the time value of money into account in determining the permissible deduction.

---

[2] A property and casualty company was permitted to deduct the full amount of the estimated loss in the year the loss occurred, even though the claim might not be paid for several years. When the claim was paid, the company would not receive any additional deduction (assuming that the payment equalled the original loss estimate) because the payment would be offset by a corresponding reduction in its unpaid loss reserve.

See S. Rep. No. 313, 99th Cong., 2d Sess. 499-500 (1986); note 2, *supra*.

Congress attempted to solve this problem by adding Section 846 to the Code as part of the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1023(c), 100 Stat. 2399. That Section requires unpaid losses to be discounted to present value when claimed as a deduction. 26 U.S.C. 846. As part of the same legislation, Congress amended Section 832(b)(5)(A) to reflect the new discounting requirements. Under that new Section, the deduction for "losses incurred" is computed by adding to losses paid "all discounted unpaid losses (as defined in section 846) outstanding at the end of the taxable year" and deducting therefrom "all discounted unpaid losses outstanding at the end of the preceding taxable year." 26 U.S.C. 832(b)(5)(A).

Congress enacted a series of transitional rules to implement these new accounting procedures. Section 1023(e)(1) of the Tax Reform Act of 1986 specifies that the new discounting rules "shall apply to taxable years beginning after December 31, 1986." 100 Stat. 2404. As the Tax Court noted (Pet. App. 34a), if no exception had been made to this new requirement, property and casualty companies would have been required to compare "old law" (undiscounted) year-end 1986 reserves with "new law" (discounted) year-end 1987 reserves, thus causing a one-time reduction of the losses incurred deduction in 1987. To avoid that sharp consequence, Congress established a transitional rule—Section 1023(e)(2) of the Tax Reform Act of 1986—which specifies that, in computing the 1987 deduction for losses incurred, the year-end 1986 reserves are also to be discounted to present value.

Without any further transitional provision, this special rule would have required property and casualty companies to take into income in 1987 the excess of their undiscounted year-end 1986 reserves over their discounted year-end 1986 reserves. This is because (i) the new requirement of discounting constitutes a change of accounting method, (ii) that new accounting method yields a double deduction for property and casualty companies[3] and (iii) Section 481(a) of the Code requires an appropriate adjustment to prevent the taxpayer from obtaining a double deduction created by a change in accounting method.[4]

[3] The double deduction may be illustrated as follows:

No discounting. Assume that an automobile accident occurs in Year 1, and the insurance company estimates it will eventually pay a total of $10 in claims stemming from that accident. Assume further that the $10 is in fact paid out in Year 5.

The tax treatment is as follows: In Year 1, the company adds $10 to its "unpaid losses," and obtains a deduction of $10. In Year 5, when the company makes the payment, it increases its "losses paid" by $10, but reduces its "unpaid losses" by $10. This is a wash.

With discounting. Assume the same facts as above. Assume, in addition, that discounting goes into effect in Year 4, and the company's "unpaid losses" account is reduced in that year, tax-free, to $9.

The tax treatment is as follows: The company again gets a Year 1 deduction of $10. In Year 5, however, when the company makes the payment, it increases its "losses paid" by $10, but reduces its "unpaid losses" by only $9, and thus gets a net additional deduction of $1. The company thus gets a total deduction (in Year 1 and Year 5) of $11 for a $10 payment.

[4] Under Section 481(a) of the Code, if the taxpayer's taxable income is computed "under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed," then

Congress decided to permit taxpayers to obtain a limited double deduction in this particular situation, however, by enacting a "fresh start" provision in Section 1023(e)(3)(A) of the Tax Reform Act of 1986. Section 1023(e)(3)(A) provides (100 Stat. 2404):

> (3) FRESH START.—
>
> (A) IN GENERAL.—Except as otherwise provided in this paragraph, any difference between—
>
> (i) the amount determined to be the unpaid losses and expenses unpaid for the year preceding the 1st taxable year of an insurance company beginning after December 31, 1986, determined without regard to paragraph (2) [*i.e.*, without discounting], and
>
> (ii) such amount determined with regard to paragraph (2) [*i.e.*, with discounting],
>
> shall not be taken into account for purposes of the Internal Revenue Code of 1986.

The double deduction provided by the "fresh start" provision gave property and casualty companies an incentive to increase their unpaid-loss reserves during the 1986 taxable year. Congress addressed that problem by enacting Section 1023(e)(3)(B) of the Tax Reform Act of 1986, which precludes application of the "fresh start" provision—and thus permits the normal application of Section 481(a)—with respect to any

---

"there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted * * *." 26 U.S.C. 481(a).

"reserve strengthening" that occurred in 1986. Section 1023(e)(3)(B) provides (100 Stat. 2404):[5]

> (B) RESERVE STRENGTHENING IN YEARS AFTER 1985.—Subparagraph (A) [the fresh start provision] shall not apply to any reserve strengthening in a taxable year beginning in 1986, and such strengthening shall be treated as occurring in the taxpayer's 1st taxable year beginning after December 31, 1986.

---

[5] The enacted version of this "reserve strengthening" provision differs from the version contained in the bill approved by the Senate Finance Committee. That bill had explicitly linked reserve strengthening to a change in the insurer's reserve practice. It provided (H.R. 3838, 99th Cong., 2d Sess., § 1022(e)(3)(B) (1986), as reported by the Senate Finance Committee, May 29, 1986):

> (B) *Reserve Strengthening After March 1, 1986.* * * * [The fresh start adjustment] shall not apply to any reserve strengthening reported for Federal income tax purposes after March 1, 1986, for a taxable year beginning before January 1, 1987, and such strengthening shall be treated as occurring in the taxpayer's 1st taxable year beginning after December 31, 1986. The preceding sentence shall not apply to the computation of reserves on any contract if such computation employs the reserve practice used for purposes of the most recent annual statement filed on or before March 1, 1986, for the type of contract with respect to which reserves are set up.

See 132 Cong. Rec. 16,130-16,131 (1986).

The Conference Committee Report explains the application of this provision (H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. at II-367 (1986)) (emphasis added):

Fresh start adjustment

The conference agreement follows the Senate amendment with respect to providing a fresh start adjustment—i.e., a forgiveness of income—for the reduction in reserves resulting from discounting the opening reserves in the first post-effective date taxable year of the provision. The conference agreement modifies the Senate amendment with respect to the treatment of reserve strengthening under the fresh start income forgiveness provision. Under the conference agreement, reserve strengthening in taxable years beginning after December 31, 1985, is not treated as a reserve amount for purposes of determining the amount of the fresh start. Instead, such reserve strengthening additions to loss reserves in taxable years beginning in 1986 are treated as changes to reserves in taxable years beginning in 1987, and are subject to discounting. *Reserve strengthening is considered to include all additions to reserves attributable to an increase in an estimate of a reserve established for a prior accident year (taking into account claims paid with respect to that accident year)*, and all additions to reserves resulting from a change in the assumptions (other than changes in assumed interest rates applicable to reserves for the 1986 accident year) used in estimating losses for the 1986 accident year, as well as all unspecified or unallocated additions to loss reserves.

This provision is intended to prevent taxpayers from artificially increasing the amount of income that is forgiven under the fresh start provision.

In 1992, the Treasury promulgated a regulation to interpret and implement this transitional rule. Section 1.846-3 of the Treasury Regulations, 26 C.F.R. 1.846-3, provides (emphasis added):

(c) *Rules for determining the amount of reserve strengthening (weakening)*—(1) *In general.* The amount of reserve strengthening (weakening) is the amount that is determined under paragraph (c)(2) or (3) to have been added to (subtracted from) an unpaid loss reserve in a taxable year beginning in 1986. For purposes of section 1023(e)(3)(B) of the 1986 Act, the amount of reserve strengthening (weakening) must be determined separately for each unpaid loss reserve by applying the rules of this paragraph (c). This determination is made without regard to the reasonableness of the amount of the unpaid loss reserve and without regard to the taxpayer's discretion, or lack thereof, in establishing the amount of the unpaid loss reserve. * * *

* * * * *

(3) *Accident years before 1986.*—(i) *In general.* For each taxable year beginning in 1986, the amount of reserve strengthening (weakening) for an unpaid loss reserve for an accident year before 1986 is the amount by which the reserve at the end of the taxable year [*i.e.*, 1986] exceeds (is less than)—

(A) The reserve at the end of the immediately preceding taxable year [*i.e.*, 1985]; reduced by

(B) Claims paid and loss adjustment expenses paid ("loss payments") in the taxable year beginning in 1986 with respect to losses that are attributable to the reserve. * * * [6]

2. The court of appeals correctly held that the definition of "reserve strengthening" under the regulation does not conflict with the "plain meaning" of the statute. As the Eighth Circuit acknowledged in *Western National*, the meaning of the term "reserve strengthening" is not apparent from the face of the statute. See 65 F.3d at 92. And, in the present case, unlike in *Western National*, the conflicting expert testimony made it clear that there is no consistent industry usage and that "the term 'reserve strengthening' as used in section 1023(e)(3)(B) is subject to more than one interpretation" (Pet. App. A9; see also *id.* at A43).[7]

---

[6] The regulation provides two exceptions from this rule: (i) an amount added to a reserve in 1986 as a result of a loss reported to the taxpayer from a mandatory state or federal assigned risk pool if the amount of the loss reported is not discretionary with the taxpayer; (ii) payments made with respect to reinsurance assumed during 1986 or amounts added to the reserve to take into account reinsurance assumed for a line of business during 1986, but only to the extent the amount does not exceed the amount of a hypothetical reserve for the reinsurance assumed. 26 C.F.R. 1.846-3(c)(3)(ii). Neither exception applies in this case.

[7] In *Massachusetts* v. *Blackstone Valley Electric Co.*, 67 F.3d 981, 986-987 (1st Cir. 1995), the court concluded that a statutory term is ambiguous when conflicting expert explanations reveal an inconsistent usage. See also *National Railroad Passenger Corp.* v. *Boston & Maine Corp.*, 503 U.S. 407, 418 (1992) ("The existence of alternative dictionary definitions of the word 'required,' each making some sense under the statute, itself indicates that the statute is open to interpretation.").

The court of appeals correctly concluded in this case that the regulation draws substantial support from the legislative history of the statute. The Conference Report, which is entitled to great weight in interpreting the statute (*National Ass'n of Greeting Card Publishers* v. *United States Postal Service*, 462 U.S. 810, 832 n.28 (1983)), expressly states, as the regulation provides, that the term "[r]eserve strengthening is considered to include *all additions to reserves attributable to an increase in an estimate of a reserve established for a prior accident year*" (Pet. App. A17, quoting H.R. Conf. Rep. No. 841, *supra*, at II-367 (emphasis added)). The court of appeals correctly noted that the Senate amendment, which had explicitly linked the "reserve strengthening" provision to changes in reserve methodologies (see note 5, *supra*), had been deleted by the Conference Committee and that the Conference Committee Report contains a far more expansive definition of the term "reserve strengthening" than the Senate Finance Committee had provided (Pet. App. A15-A19). The court correctly concluded that the definition of "reserve strengthening" set forth in the regulation must be sustained because it is consistent with the text and history of the statute and advances its purpose of preventing abuses of the "fresh start" provision (*id.* at A22-A23).

3. Petitioner contends (Pet. 12-15) that the definition of "reserve strengthening" set forth in the regulation is inconsistent with the use of that same term in the provisions applicable to *life* insurance reserves

enacted in Section 216(b)(3) of the Tax Reform Act of 1984, Pub. L. No. 98-369, Div. A, 98 Stat. 759.[8] In that provision, enacted two years before the statute involved in this case, Congress provided a fresh start adjustment for life insurance reserves and, in making that adjustment inapplicable to "any reserve strengthening" after 1984, specified that the "reserve strengthening" limitation "shall not apply * * * if [the reserve] computation employs the reserve practice used * * * before * * * for the type of [insurance] with respect to which such reserves are set up." *Ibid.*

As the court of appeals correctly concluded (Pet. App. 14a-15a), the specific exception from the "reserve strengthening" provision applicable to life insurance reserve computations supports the interpretation of that term (as used in Section 1023(e)(3)(B)) contained

---

[8] The 1984 legislation provided (emphasis added):

(3) REINSURANCE TRANSACTIONS, AND RESERVE STRENGTHENING, AFTER SEPTEMBER 27, 1983.—

(A) IN GENERAL.—Paragraph (1) [*i.e.*, the fresh start adjustment] shall not apply * * *

* * * * *

(ii) to any reserve strengthening reported for Federal income tax purposes after September 27, 1983, for a taxable year ending before January 1, 1984.

Clause (ii) shall not apply to the computation of reserves on any contract issued if such computation employs the reserve practice used for purposes of the most recent annual statement filed before September 27, 1983, for the type of contract with respect to which such reserves are set up.

in Section 1.846-3(c)(3) of the Treasury Regulations.[9] In enacting the life insurance provisions, Congress *excluded* ordinary increases in reserves from the operation of the "reserve strengthening" clause. A similar exclusion was contained in the Senate version of Section 1023(e)(3)(B), which was deleted by the Conference Committee. As the court of appeals correctly observed (Pet. App. 14a), the deletion of this exclusion of ordinary reserve increases from the operation of the "reserve strengthening" clause reflects, as the express language of the Conference Report indicates, that Congress did *not* intend to restrict the "reserve strengthening" provision in Section 1023(e)(3)(B) to changes in reserve practices. "Where Congress includes limiting language in an earlier version of a bill but deletes it prior to enactment, it may be presumed that the limitation was not intended." *Russello* v. *United States*, 464 U.S. 16, 23-24 (1983).[10]

---

[9] The court of appeals also correctly distinguished the definition of "reserve strengthening" used in the life insurance industry from the definition of "reserve strengthening" for the property and casualty industry (Pet. App. 12a-14a). As the court explained (*ibid.*), there are fundamental differences between the reserve-setting process in the life insurance industry (which is predicated upon external factors such as mortality tables and interest rates) and the reserve-setting process in the property and casualty industry (which looks to past claims experience and also involves a fact-specific determination by the individual claims adjuster based upon his or her judgment and experience).

[10] The Conference Committee Report emphasize that "[t]he conference agreement modifies the Senate amendment with respect to the treatment of reserve strengthening" and provides a more expansive definition of the term (for pre-1986 accident years) than the Senate Finance Committee had

Petitioner thus errs in relying on the untenable proposition that courts should adopt the very version of Section 1023(e)(3)(B) that had been proposed by the Senate but rejected by the Conference. As this Court has emphasized, courts have a "duty to refrain from reading a phrase into the statute when Congress has left it out." *Keene Corp.* v. *United States*, 508 U.S. 200, 208 (1993).[11]

4. Although the decision of the court of appeals in the present case is correct, we agree with petitioner that the decision in this case conflicts with the

---

provided. H.R. Conf. Rep. No. 841, *supra*, at II-367. The intent of the Conference Committee to expand the definition of "reserve strengthening" was so clear that it provoked criticism from Senator Wallop, an opponent of that action (Pet. App. 18a).

[11] Petitioner errs in asserting (Pet. 11) that *Rowan Cos.* v. *United States*, 452 U.S. 247 (1981), supports the conclusion that Congress incorporated the life insurance provisions relating to reserve strengthening in enacting Section 1023(e)(3)(B). In *Rowan*, the Court invalidated a Treasury regulation that gave the term "wages" a different interpretation for purposes of federal employment taxes than the same term had for purposes of income tax withholding. The Court emphasized that (i) the respective statutes contain virtually identical definitions of the term and (ii) the legislative history accompanying the income tax witholding statute indicated that the term was to be construed consistently with the federal employment tax statutes. 452 U.S. at 255-257. Section 1023(e)(3)(B), however, does not contain a definition of "reserve strengthening." The language of Section 1023(e)(3)(B) also differs materially from the language of the life insurance "reserve strengthening" provision. And, as the Third Circuit correctly recognized (Pet. App. 15a-23a), the legislative history of Section 1023(e)(3)(B) conclusively demonstrates that Congress did not intend to restrict the definition of "reserve strengthening" to reserve increases resulting from changes in reserve practices.

decision of the Eighth Circuit in *Western National Mutual Insurance Co.* v. *Commissioner*, *supra*. In *Western National*, the court of appeals adopted the Tax Court's factual "determination that reserve strengthening has a settled meaning in the property and casualty industry" and that, in industry usage, "reserve strenghtening occurs 'when a method or assumption used in calculating policy reserves is changed so as to produce higher reserves.'" 65 F.3d at 93, quoting *Western National Mutual Insurance Co.* v. *Commissioner*, 102 T.C. 338, 351 (1994). The court concluded in *Western National* "that reserve strenghtening is an example of congressional employment of industry language" and, in view of the "settled meaning" of the term in the insurance industry, "reserve strengthening is not an ambiguous term." 65 F.3d at 92, 93. The court reasoned in *Western National* that the agency's interpretive regulation is invalid because "it adopts a definition of reserve strengthening that is at variance with industry usage." *Id.* at 93.

The Third Circuit correctly observed that the record of the present case (Pet. App. 9a) differs from the record involved in *Western National*. In *Western National*, the Commissioner did not contest the expert testimony that the taxpayer introduced—and on which the court relied—to establish that reserve strengthening "has a settled meaning in the property and casualty industry" (65 F.3d at 93). In the present case, by contrast, the Commissioner introduced expert testimony that established that the term "reserve strengthening" lacks any precise industry usage and "is subject to more than one interpretation" (Pet. App. A9 & n.5). See also *id.* at A43.

Whether, on this different and more complete factual record, the Eighth Circuit would reach a different conclusion on the question presented in this case is, of course, impossible to determine in advance with certainty. It is possible that proof of the type submitted in this case—establishing that the term "reserve strengthening" lacks a definite usage in the property and casualty industry—would lead that court to reconsider its prior holding.[12] It is certain, however, that further litigation of this issue would be required, in both the Eighth Circuit and other circuits as well, in an attempt to bring about a uniform resolution of this question.

Although the issue presented in this case involves a transitional rule that affects the calculation of taxes for the property and casualty industry only for the 1987 tax year, we are advised by the Internal Revenue Service that the identical issue is presented in numerous pending cases, with estimated total adjustments exceeding $1 billion. The inconsistent results that have been reached thus may have substantial disparate effects on companies that compete with one another. Review by this Court of this substantial

[12] The court of appeals noted in the present case that, although the Eighth Circuit had based its decision in *Western National* on its understanding of industry usage, that court had "nonetheless proceeded to examine the legislative history * * * and determined that it failed to provide persuasive rationale for intepreting 'reserve strengthening' contrary to industry usage" (Pet. App. A12 n.7). By contrast, on the different record of this case, the Third Circuit found no persuasive evidence of any consistent industry usage and concluded that the legislative history persuasively explained that the agency had correctly interpreted the ambiguity inherent in the text of the provision (*id.* at A9-A25).

recurring question, on which the courts of appeals have reached inconsistent conclusions, would be appropriate.

CONCLUSION

The petition for a writ of certiorari should be granted.[13]

Respectfully submitted.

SETH P. WAXMAN
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
DAVID I. PINCUS
EDWARD T. PERELMUTER
Attorneys

SEPTEMBER 1997

[13] In light of the support for the Commissioner's position reflected in the legislative history we have recounted and the deference owing to the interpretation set forth in the pertinent Treasury Regulation (see, *e.g.*, *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 488 (1979)), the Court may wish to consider summary affirmance.